

CORPORATE GOVERNANCE AND THE ROLE OF FORENSIC ACCOUNTANTS IN SAUDI ARABIA

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ABSTRACT

The primary subject matter of this research is to investigate the role of forensic accountants in a corporation with sound fraudulent activities. To what extent does forensic accounting effect fraud detection in a developing country such as Saudi Arabia? Can forensic accountants stop fraudulent activities? The development of proper corporate governance in response to the indicators of possible financial fraud and clarifying the expected role of forensic accountants in the Saudi publicly traded corporation is of high importance. In addition, some explanation for the diverging views among academics and regulators in relation to the expected role of forensic accountants will be presented. The collected data were analyzed with descriptive statistics using ordinary least square (OLS) regression and Chi-square. The study reveals that the application of forensic accounting services on corporations does not affect the level of fraudulent activities in Saudi Arabia.

KEYWORDS: *Corporate Governance, Forensic Accounting, Fraud and Saudi Arabia*

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INTRODUCTION

Corporate governance received more attention due to a series of corporate failures that affected not only those directly connected with the companies concerned (i.e., directors, shareholders and auditors) but also those affected by its existence like employees, customers, suppliers and the environment. The first well-documented failure of governance was the South Sea Bubble in the 1700s, which revolutionized business laws and practices in England (Iskander et al., 1999).

The Asian financial crisis, which started with the devaluation of the Thai baht in July 1997, brought to the foreground the common occurrence of weak corporate governance which had allowed companies to engage in excessive over-leverage, some of which were aided by implicit state guarantees. The concepts of transparency, disclosure and accountability were largely ignored in the lead-up to the crisis as investors assumed a short-term outlook in order to derive increasing profits from the steadily rising regional financial markets.

All corporations in Saudi Arabia and in the world are subject to fraud risks. International large frauds and crises as mentioned above have led to the downfall of the entire corporations, significant legal costs and noticeable business and investment losses which effect the confidence of investors and stakeholders. The financial crises mainly driven by undetected fraud and the increased corporate governance weaknesses in Saudi corporations has led to the need for multi-dimensional relationship (that is inter-relationship between the audit committee, the external auditor and the management) in corporate governance as to protecting the interest of shareholders and other stakeholders with the common goal of improving oversight function and ensuring good

corporate governance (Deloitte and Touch 2006). Weak corporate governance accompanied with financial fraud have led to poor performance and to corporate collapse resulting to huge lost of new investment (Rezae 2005). The abovementioned corporate structure failure has made academics and investigators realize that there is a great need for forensic accountants who can identify, expose and prevent corporate governance weaknesses and detect fraudulent financial statements.

Forensic Accountants could be identified as experienced investigators of financial data who are external and could be contracted to detect suspicions of fraudulent financial activities and improve corporate governance practices which will finally lead to better performance. Forensic accountants can play vital role to improve corporate governance in a company by improving the company's control and accounting systems that ensures a proper recording, classification and reporting of all relevant transactions. Forensic accountants should always put an eye on corporate governance practices to ensure good corporate governance and improve responsibilities and accountability. They should also ensure the integrity of financial statements by actively investigating for fraud, identifying areas of risk and associated fraud symptoms, pursuing each anomaly aggressively, and delving into the finest details of accounting and financial anomalies.

Saudi regulators such as the Saudi Organization for Certified Public Accountant (SOCPA), Saudi Capital Market Authority (CMA), Saudi Arabia Monetary Agency (SAMA), and Ministry of Commerce and Investment and similar legislation throughout the world have increased management's responsibility for fraud risk management. Every corporation is susceptible to fraud, but not all fraud can be prevented, nor is it cost-effective to try.

The next section presents an overview of searching and evaluating the related literature and states the suggested hypotheses. The research methodology is covered in the following section. Then the final section concludes with the research results and summarizes the main findings reported in this research.

LITERATURE REVIEW

Forensic Accounting and corporate governance investigation has become important to the practitioners, accounting academics, researchers, investors, and to the public. This importance of corporate governance and forensic accounting is duly because of the disastrous failure of big businesses such as Enron, WorldCom, Adelphia, Global Crossing, Xerox, Qwest, Cendant, Lincoln Savings, ESM, Anicom, Waste Management, and Sunbeam, etc (Albrecht, 2005).

The issue transcends national boundaries. Both the United States and Europe have had their share of questionable management decisions leading to the loss of billions of dollars, including Enron Corp. and Long Term Credit Management in the United States and Morgan Grenfell in Europe (Chambers, 2002). Australia has also not been immune as evident from the recent collapses of one. Tel Ltd and HIH Insurance Limited, a telecommunications and an insurance company, respectively. These are but a few of the well-documented cases that highlight the increasing importance of effective corporate governance and the role of forensic accountants. The financial crises in Asia, Russia, United States and Australia, amongst others, have shown that a lack of regard for core values of corporate governance does have a negative impact globally. Corporations and regulatory bodies in Saudi Arabia are now trying to analyze and correct any existing defects in their reporting system. In the current reporting environment, forensic accountants are in great demand for their accounting, auditing, legal, and investigative skills. Forensic accountants are expected to explore the design of the corporate governance systems, the role of the financial reporting system in corporate governance, the effect of the governance board on employee and managerial behaviour, and the efficacy of the internal control systems.

Countries, markets and companies that have not been able to survive or that have fared badly in a crisis have one thing in common: poor corporate governance standards (Keong, 2002). Those financial crises showed that even strong economies lacking transparent control, responsible corporate boards and shareholder rights collapse quite quickly as investor's confidence erodes.

Empirical evidence (Fremond et al., 2002) suggests that good corporate governance increases the efficiency of capital allocation within and across firms, reduces the cost of capital for issuers, helps broaden access to capital, reduces vulnerability to crises, fosters savings provisions and renders corruption more difficult.

Owojori and Asoula (2009) states that the Failure of Statutory audit to prevent and reduce misappropriation of corporate fraud and increase in corporate crime has put pressure on the professional accountant and legal practitioner to find a better way of exposing fraud in business world.

A careful study of corporate governance is important at the present time in Saudi Arabia because the future will be even more competitive than it is now. In emerging market economies the business environment lacks many elements needed for a competitive market and a culture of enforcement and compliance (Iskander et al., 1999). Saudi Arabia needs to take a long hard look at the way other countries' systems work and keep their own under review.

PricewaterhouseCoopers' (PWC) 2003 Global Crime Survey shows that 37 percent of respondents in 50 different countries reported significant economic crimes with the average loss per company of \$2,199,930 (PWC, 2003). KPMG's Fraud Survey (2003) also concluded that more companies are: recently experiencing incidents of fraud than in prior years; taking measures to combat fraud; and launching new antifraud initiatives and programs in response to the Sarbanes-Oxley Act of 2002 (KPMG 2003).

H1: Forensic Accounting Does Not Affect Fraud Detection in Saudi Arabia

To remain competitive in a changing world, Saudi corporations should update and control their corporate governance practices so that they can meet new demands and new opportunities. The Saudi government also has an important responsibility for shaping an effective regulatory framework that provides for sufficient flexibility to allow the Saudi market to function effectively and to respond to expectations of shareholders and other stakeholders. The way these principles should be adopted is the responsibility of the government and the market participants. Forensic Accountants can make significant contributions in the area of corporate governance, fraud prevention and investigation, creating positive work environment, establishing effective lines of communication and vigilant oversight.

H2: Forensic Accounting Cannot Stop Fraudulent Activities in Saudi Arabia

This research is concerned directly with the manner in which joint stock corporations are managed in Saudi Arabia. However, in formulating an analytical framework for addressing governance issues, the author prefers to draw a distinction between, on the one hand, elements of good governance and, on the other, the role of forensic accountants in which they could be promoted or their existence enhanced in a developing country.

METHODOLOGY

The survey is a flexible research approach used to investigate a wide range of topics and it will be the research methodology adopted for this study. The choice was predicted on the fact that descriptive survey method is one which looks with intense accuracy at the phenomena of the moment and then describes precisely what the researcher sees

(Saunders et al, 2003). Surveys often employ the questionnaire as a tool for data collection and the use of questionnaires is the most widely used data collection technique in a survey and, in this study. The data collected are analyzed using Chi-square statistical software and OLS regression analysis.

RESULTS

The primary subject matter of this research is the development of a proper corporate governance in response to the indicators of possible financial fraud and clarifying the expected role of forensic accountants in an organization in the context of Saudi Arabia. The study attempts to examine empirically the impact of forensic accounting on fraud detection, therefore, the following regression is tested:

$$FD = \alpha + \beta_1 CASH + \beta_2 FA + \beta_3 CF + \beta_4 RC + \beta_5 SF + \varepsilon$$

Where;

FD: Fraud Detection

CASH: Cash Stealing

FA: Forgery of Accounts

CF: Cashiering Fraud

RC: Rigged Checks

SF: System Fraud

The collected data were analyzed with descriptive statistics using ordinary least square (OLS) regression and Chi-square. The study reveals that the application of forensic accounting services on firms affects the level of fraudulent activities. The best linear unbiased estimator of the unknown parameters is obtained by minimizing the residual (error) sum of squares.

Table 1: Coefficients

Variables	Unstandardized Coefficients		Standardized Coefficients (β)	(t)	Sig.	95% Confidence Interval for b	
	B	Std. Error				Lower Bound	Upper Bound
α	-1254.527	725.237		-3.238	.144	-34.602	6.660
CASH	-.001	.003	-.004	-.218	.682	2.577	3.454
FA	-192.237	23.591	-.021	- 16.628	.007	-12.286	2.843
CF	314.581	.421	.901	527.71	.000	1.594	2.913
RC	.000	.000	.005	1.281	.221	.0218	1.028
SF	.000	.001	-.051	-.628	.618	.1052	1.241

Therefore, the regression could be read as follows:

$$FD = -1254.527 -.001 CASH - 192.237 FA + 314.581 CF + .000 RC + .000 SF$$

By looking at the regression results in Table 1 above, it could be concluded that the results in general are satisfactory. The diagnostic statistics generated from the estimation shown above are very much impressive. For example, after adjusting for degrees of freedom, the R bar squared stood at 1.000, accounting which is about 100% of the total

variations in the fraud detection carried out satisfies the sample period 2007-2012, justifying apparently that the fit to the data to the model was very good. The f-statistic again reinforced this.

Table 2: Anova

Source	Sum of Squares	DF	Mean Square	F	Sig.
Regression	625487215.77	6	1952154863	251463.56	.000
Residual	2358415.215	3	63.2389		
Total	627845630.985	9	1952154926.2389		

The degrees of freedom used to calculate the (P) value is given by the Error (DF) from the ANOVA table above. It could be seen that with an f-value of (251463.56) the overall model is found to be significant and the model as a whole has statistically significant predictive capability. Under the null hypothesis that the model has no predictive capability, the hypothesis of an existence of significant linear relationship between fraud detection and forensic accounting (explanatory variables are taken together: cash stealing, forgery of accounts, cashiering fraud, rigged checks, and system fraud) is validated.

Table 3: Model Summary (B)

R	R square	Adjusted R Square	Std. Error of the Estimate
1.000 (a)	1.000	1.000	1351.21504
a. Predictors: (Constant), CASH, FA, CF, RC, SF			
b. Dependent Variable: FD (Fraud Detection)			

The standard-error of estimation is also high at 1351.21504, hence the probability that the sample measures are a reliable representation of the full population. The determination of the representativeness of the current sample is based on the theoretical sampling distribution the behavior of which is described by the central limit theorem. The standard error of our estimation to the mean of the fraud detection (the dependent variable) is 725.237. This again implies that a very high forecasting performance is associated with the estimated equation.

To test the null hypothesis of the regression coefficient the author divides the regression coefficient by its standard error. This procedure will standardize the regression coefficient. It also means that the sampling distribution of the standardized regression coefficient, under the null hypothesis, has an expected mean of 0 and a standard deviation of 1. Therefore, if the ratio of the regression coefficient to its standard error is lower than -1.96 or higher than 1.96, it will be considered as significantly different from 0, which is the case in the current study. Both the residual variance and the error of prediction are very high and obviously above 1.96.

Table 4: Excluded Variables

Variable	Beta in	T	Sig.	Partial Correlation	Collinearity Statistics
					Tolerance
DF (Diversified Fraud)	.829	28.061	.026	1.000	4.325978521
a. Predictors: (Constant), CASH, FA, CF, RC, SF					
b. Dependent Variable: FD (Fraud Detection)					

The (T) statistic in Table 4 above tests the hypothesis that a population regression coefficient is (0) when the other predictors are in the model. Considering the individual significance of the variables, all the variables of the current study appear to have passed the significance test even at the conservative 1% level. Thus, with a t-value of (28.061) is greater

than the table t-value of 0.22 (also greater than the table t-value even at the conservative 5% level of 0.45). Therefore, it could be concluded that the coefficient of the fraud detection variable is significantly different from zero.

It could be concluded, therefore, by the statistics and the results shown above that the first hypothesis that forensic accounting in Saudi Arabia does not affect fraud detection is accepted. The author also rejects the null hypothesis and accepts the alternate that forensic accounting cannot stop fraudulent activities in Saudi Arabia. In other words, forensic accountants in Saudi Publicly traded companies cannot curb fraudulent activities. The ineffectiveness of the employment of forensic accounting by publicly traded companies in Saudi Arabia has strong implications for sound corporate governance. Companies in Saudi Arabia need a centralized program and an established system to measure and monitor internal controls effectiveness and the alignment between corporate governance, internal control, and external reporting activities. The best way to prevent fraud is to establish an efficient control system that encompasses: a good control environment determined by management's philosophy of ethical behavior and strong corporate governance policies and a superior accounting system that ensures the proper recording and classification.

CONCLUSIONS

On the basis of this finding, the author concludes that forensic accountants in Saudi Arabia is still raw and needs more development and intensive care to provide Saudi corporations with the necessary tools to deter fraudulent activities. Forensic accounting may be a new term in Saudi Arabia and it needs more development and regulating. The following recommendations could be considered:

- The traditional auditing practices in the Saudi public corporations may not work in detecting fraudulent activities, so they need more improvement and update;
- Saudi government and regulatory authorities should ensure the provision of standards and guidelines to regulate forensic accounting;
- Fraud risk exposure should be assessed periodically by the Saudi publicly traded corporations to identify specific potential schemes and activities that the corporation needs to mitigate;
- Detection techniques should be established in all corporations and monitored by Saudi regulating and governance bodies to uncover fraud activities, especially when preventive measures fail or unmitigated risks; and
- More academic and practical research is needed in the area of forensic accounting and corporate governance in such an attractive developing country to prevent fraud, improve its regulations, and link it to the international investors.

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